Investments

Chapter 15

Wild and Shaw

Fundamental Accounting Principles

25th Edition

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Chapter 15 Learning Objectives

CONCEPTUAL

C1 Distinguish between debt and equity securities and between short-term and long-term investments.

C2 Describe how to report equity securities with controlling influence.

ANALYTICAL

A1 Compute and analyze the components of return on total assets.

PROCEDURAL

P1 Account for debt securities as trading.

P2 Account for debt securities as held-to-maturity.

P3 Account for debt securities as available-for-sale.

P4 Account for equity securities with insignificant influence.

P5 Account for equity securities with significant influence.

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Learning Objective C1

Distinguish between debt and equity securities and between short-term and long-term investments.

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Basics of Investments

Motivation for Investments

1. Companies invest *extra cash* into investments to earn more income.
2. Some entities are set up to earn income from investments.
3. Companies make investments for strategic reasons.

Learning Objective C1: Distinguish between debt and equity securities and between short-term and long-term investments.

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Investments of Selected Companies

Short-Term (ST) and Long-Term (LT) Investments as a Percent of Total Assets

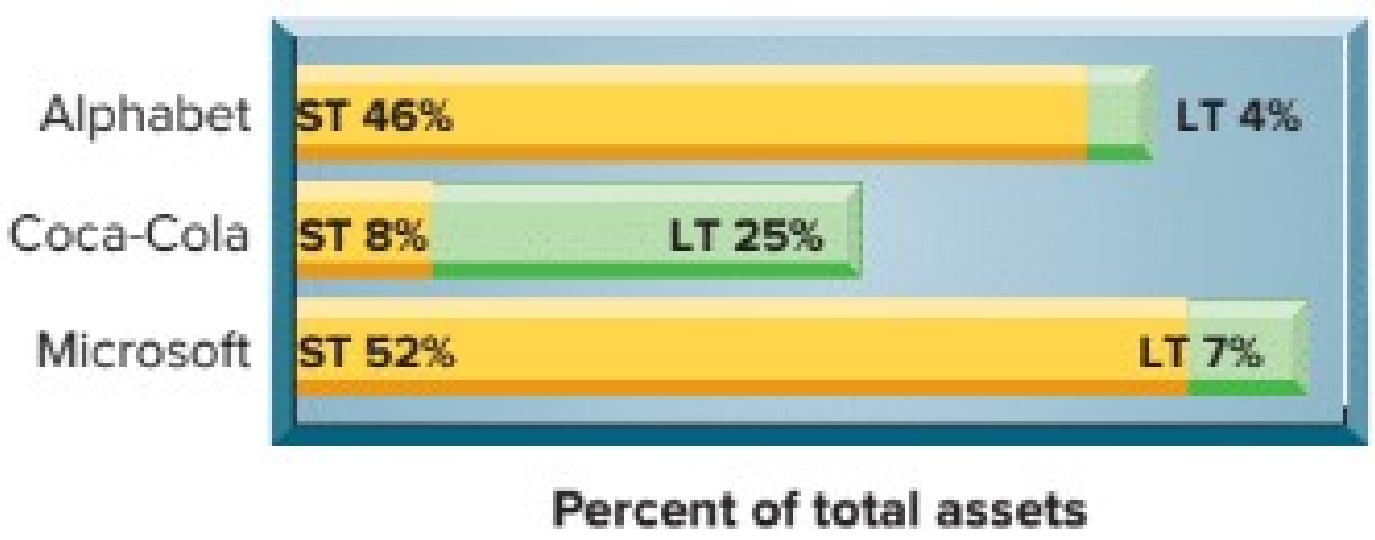

Exhibit 15.1

Learning Objective C1: Distinguish between debt and equity securities and between short-term and long-term investments.

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Short-Term Investments

Short-term investments are securities that:

- **Management intends to convert to cash within one year.**
- **Are readily convertible to cash.**
- **Usually mature between 3 and 12 months.**

Learning Objective C1: Distinguish between debt and equity securities and between short-term and long-term investments.

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Long-Term Investments

Long-term investments are:

- Not readily convertible to cash.
- Not intended to be converted to cash in the short term.
- Reported in the noncurrent section of the balance sheet, often in its own category.

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Debt Securities versus Equity Securities

Debt Securities

- Reflect a creditor relation
- Examples: Investments in notes, bonds, and CDs
- May be issued by governments, companies, or

Equity Securities

- Reflect an owner relation
- Examples: Investments in shares of stock
- Issued by companies

Learning Objective C1: Distinguish between debt and equity securities and between short-term and long-term investments.

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Classification and Reporting

Accounting for Investments depends on three factors:

1. **Security type: debt or equity**
2. **Intent to hold the security short or long term**
3. **Percentage ownership in another company's equity securities**

Exhibit 15.2

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Debt Investments: Acquisition

- Debt investments are recorded at cost.
- On July 1, 2021, Ling Co. paid $30,000 to buy Dell's 7%, 2-year bonds payable with a $30,000 par value.
- The bonds pay interest semiannually on December 31 and June 30.

July 1, 2021	Debt Investments	30,000	
	Cash		30,000
	Purchased bonds as debt investments.		

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Debt Investments: Recording Interest and Reporting

- Interest revenue is recorded when earned.
- $30,000 par value × 7% × 6/12 = $1,050 interest earned from July 1 to December 31.

Dec. 31, 2021	Cash	1,050	
	Interest Revenue		1,050
	Record interest earned ($30,000 × 7% × 6/12).		

Exhibit 15.3

On the income statement for year 2021:		On the December 31, 2021, balance sheet:	
Interest revenue	**$1,050**	**Debt investments**	**$30,000**

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Debt Investments: Maturity

When the bonds mature, Ling Co. will receive the amount of the par value in cash.

July 1, 2023	Cash	30,000	
	Debt Investments		30,000
	Received cash from matured bonds.		

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Learning Objective P1

Account for debt securities as trading.

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Debt Investments – Trading

1. Debt investments
2. Actively managed for profit
3. Always current assets
4. Portfolio reported at fair value
5. Unrealized gain or loss from change in fair value reported in the income statement

Learning Objective P1: Account for debt securities as trading.

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Debt Investments: Trading Recording and Reporting Fair Value

- TechCom's portfolio of trading securities had a total cost of $11,500, and a fair value of $13,000, on December 31, 2021, the first year the securities were held.
- The $1,500 difference between the cost of $11,500 and the fair value of $13,000 is an unrealized gain.

Dec. 31, 2021	Fair Value Adjustment—Trading	1,500	
	Unrealized Gain—Income		1,500

Current Assets

Debt investments—Trading (at cost)	$11,500	
Fair value adjustment—Trading	1,500	
Debt investments—Trading (at fair value)		$13,000

or simply

Debt investments—Trading (at fair value; cost	$13,000

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Debt Investments – Trading Selling Trading Securities

- Assume TechCom sells trading securities that had cost $100 for $120 cash, on January 9, 2022.
- The gain is reported in the Other Revenues and Gains on the Income Statement.
- A loss would be reported in Other Expenses and Losses.

Jan. 9, 2022	Cash	120	
	Debt Investments—Trading		100
	Gain on Sale of Debt Investments		20
	Sold trading securities costing $100 for $120 cash.		

Learni securities as trading.

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Learning Objective P2

Account for debt securities as held-to-maturity.

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Debt Investments: Held-to-Maturity

1. Debt securities company intends to hold to maturity
2. Reported as:
   a) Current assets if maturity dates are within one year or the operating cycle, whichever is longer
   b) Noncurrent investments if their maturity dates are longer
3. Portfolio of HTM securities reported at amortized cost
4. No fair value adjustment to the portfolio

Learning Objective P2: Account for debt securities as held-to-maturity.

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Learning Objective P3

Account for debt securities as available-for-sale.

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Debt Investments: Available-for-Sale

1. Debt investments not classified as trading or held-to-maturity.
2. Reported as:
   a) Short-term investments if intent to sell within one year or the operating cycle, whichever is longer.
   b) Long-term investments if securities do not meet short-term criteria.
3. Valued at fair value.
4. Unrealized gains or loss reported in equity section of balance sheet as part of comprehensive income.

Learning Objective P3: Account for debt securities as available-for-sale.

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Available-for-Sale: Recording Fair Value

- Mitsu Co. had no prior investments.
- In the current period, it acquired two available-for-sale securities as shown below.
- At December 31, 2021 the year-end adjusting entry to record fair value is shown.

	Cost	Fair Value	Unrealized Gain (Loss)
Apple bonds	$30,000	$29,050	$ (950)
Intex notes	43,000	45,500	2,500
T			

Exhibit 15.4

	Dec. 31, 2021	Fair Value Adjustment—Available-for-Sale	1,550	
		Unrealized Gain—Equity		1,550
		Record adjustment to fair value of AFS securities.		

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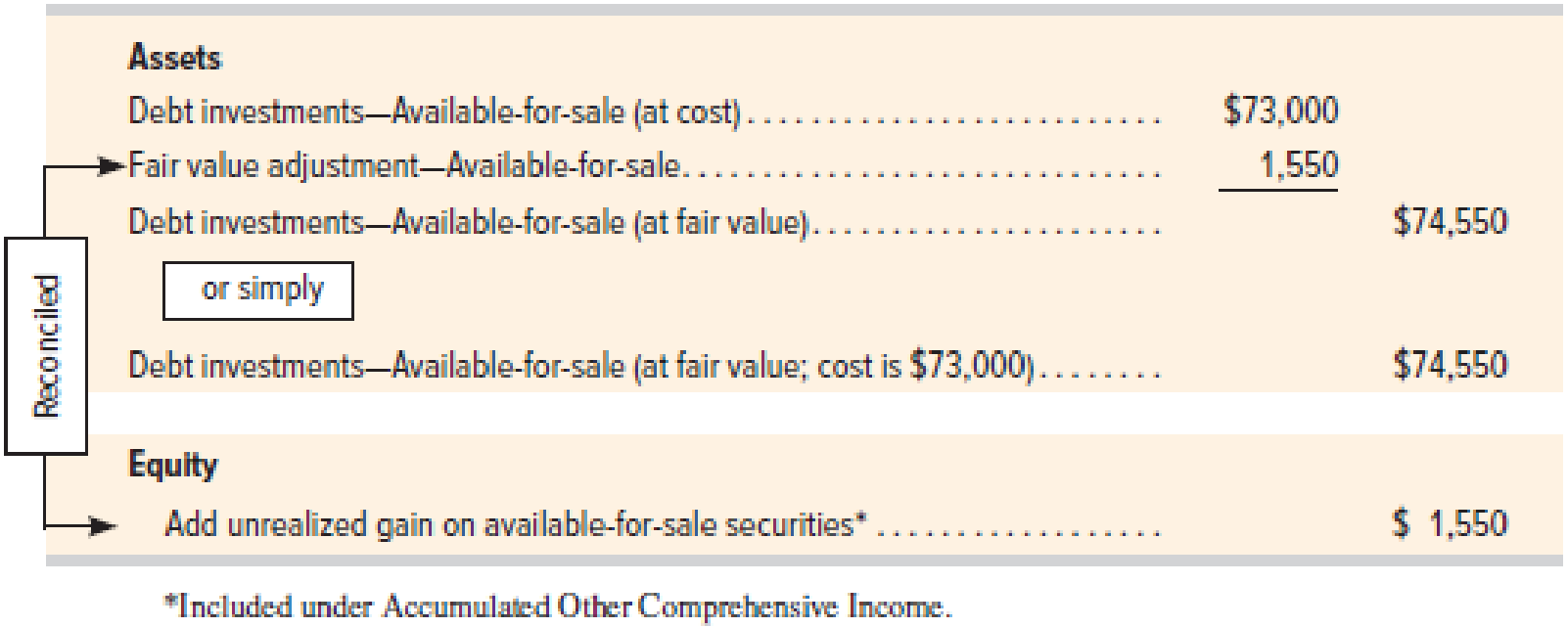
Available-for-Sale: Reporting Fair Value

Exhibit 15.5



Assets		
Debt investments—Available-for-sale (at cost)	$73,000	
Fair value adjustment—Available-for-sale	1,550	
Debt investments—Available-for-sale (at fair value)		$74,550
or simply		
Debt investments—Available-for-sale (at fair value; cost is $73,000)		$74,550
Equity		
Add unrealized gain on available-for-sale securities*		$ 1,550

Reconciled

*Included under Accumulated Other Comprehensive Income.

Learning Objective P3: Account for debt securities as available-for-sale.

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Available-for-Sale: Reporting for Next Year

Let's extend our example and assume that at December 31, 2022, Mitsu's portfolio of long-term AFS securities has an $81,000 cost and an $82,000 fair value.

Dec. 31, 2022	Unrealized Gain—Equity	**550**	
	Fair Value Adjustment—Available-for-Sale		**550**

Unrealized Gain—Equity			**Fair Value Adjustment—**		
		Bal. 12/31/21 1,550	Bal. 12/31/21 1,550		
Adj. 12/31/22	**550**			Adj. 12/31/22	**550**
		Bal. 12/31/22 1,000	Bal. 12/31/22 1,000		

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Learning Objective P4

Account for equity securities with insignificant influence.

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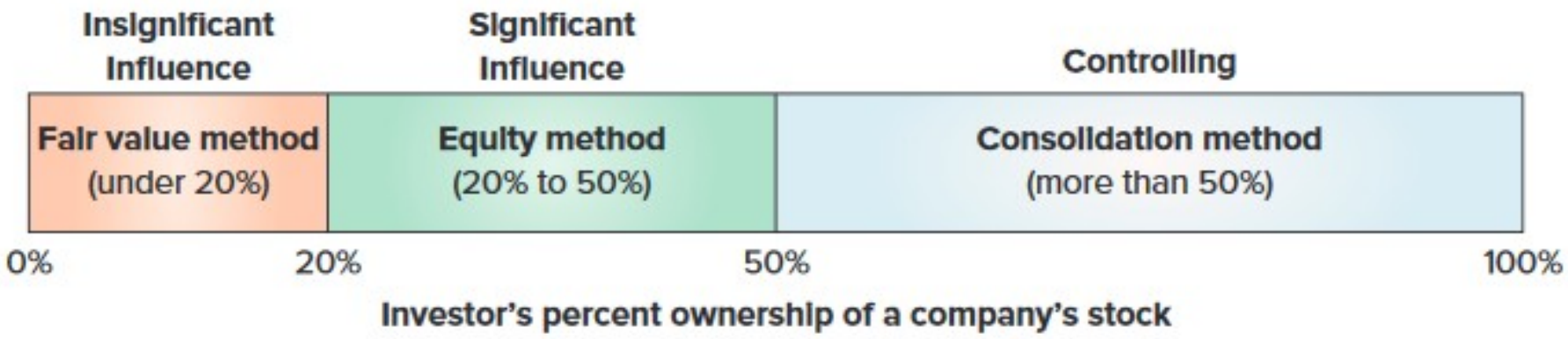
Accounting for Equity Investments Based on Ownership Percentage

Exhibit 15.6



Learning Objective P4: Account for equity securities with insignificant influence.

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Equity Investments Insignificant: Recording Acquisition

- Equity investments are recorded at cost when acquired, including any commissions or brokerage fees paid.
- ITI purchased 100 shares of Lynx for $7,000.

Oct. 10	Stock Investments	7,000	
	Cash		7,000
	Purchased 100 shares of Lynx.		

Learning Objective P4: Account for equity securities with insignificant influence.

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Equity Investments Insignificant: Recording Dividends

- On 11/1, ITI receives $10 in dividends.
- Cash is debited and Dividend Revenue is credited.

Nov. 1	Cash	10	
	Dividend Revenue		10
	Record dividend received on stock investments.		

Learning Objective P4: Account for equity securities with insignificant influence.

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Equity Investments Insignificant: Recording Fair Value

- ITI's portfolio of stock investments with insignificant influence, has a cost of $7,000.
- Fair value is $9,000 on 12/31/21.
- First year securities held.
- Unrealized gain = $9,000 − 7,000 = $2,000.

Dec. 31	Fair Value Adjustment—Stock	2,000	
	Unrealized Gain—Income		2,000
	Record unrealized gain in stock investments.		

Learning Objective P4: Account for equity securities with insignificant influence.

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Stock Investments: Insignificant Reporting Fair Value

- Unrealized gain, a temporary account, is reported in Other Revenues and Gains (or Expenses and Losses) on the Income Statement.
- Fair Value Adjustment – Stock, is a permanent asset which reports adjustments in portfolio.
- Total cost kept in one account and fair value adjustment kept in separate account. Reported in assets as shown be

Assets

Stock investments (at cost)	$7,000	
Fair value adjustment—Stock	2,000	
Stock investments (at fair value)		$9,000
or simply		
Stock investments (at fair value; cost is $7,000)		$9,000

Learning Objective P4: Account for equity securities with insignificant influence.

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Stock Investments Insignificant: Selling Stock Investments

- When individual stock investments are sold, difference between net proceeds and cost recorded as gain or loss.
- Prior-period fair value adjustments not used to compute gain or loss from sale of individual stocks.
- 3/9/22: ITI sold individual stock with cost of $500

Mar. 9	Cash	800	
	Stock Investments		500
	Gain on Sale of Stock Investments		300
	Sold stock investments costing $500 for $800 cash.		

Learning Objective P4: Account for equity securities with insignificant influence.

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Learning Objective P5

Account for equity securities with significant influence.

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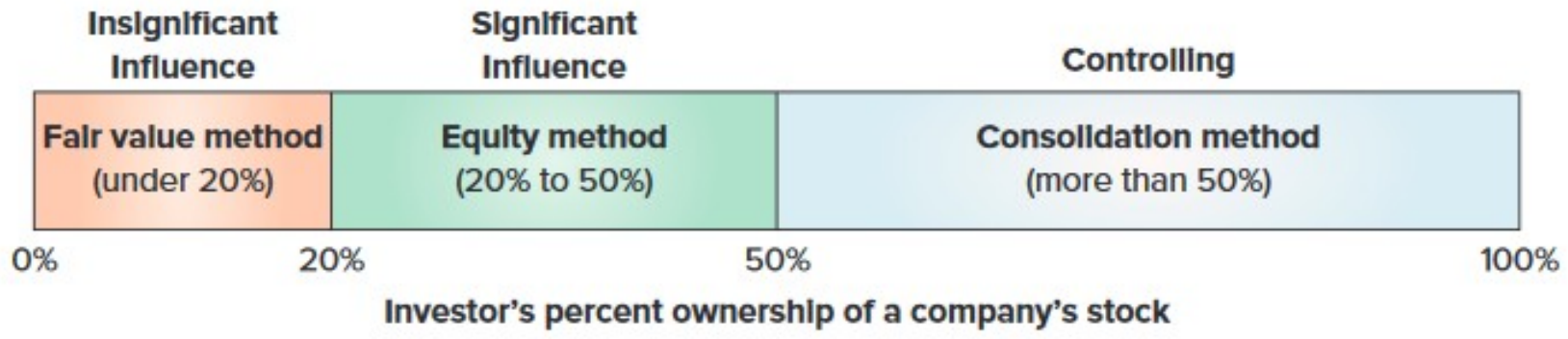
Equity Investments: Significant Influence, 20% - 50%

Investor Percentage Ownership of Investee Shares Outstanding

Exhibit 15.6



Learning Objective P5: Account for equity securities with significant influence.

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Equity Investments Significant Influence: Recording Acquisition

On January 1, 2021, Micron Co. records the purchase of 3,000 shares (30%) of Star Co. common stock at a total cost of $70,000 cash.

Jan. 1	Equity Method Investments	70,000	
	Cash		70,000
	Record purchase of 3,000 Star shares.		

Learning Objective P5: Account for equity securities with significant influence.

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Equity Investments Significant Influence: Recording Share of Earnings

- On December 31, 2021, Star reports net income of $20,000 for 2021.
- Micron records $6,000 share of earnings: $20,000 × 30% = $6,000.
- Debit increases Micron's equity in Star.
- Credit increases Earnings from Equity Method Investments which is a temporary account closed to Income Summary and reported on income statement.

Dec. 31	Equity Method Investments	6,000	
	Earnings from Equity Method Investments		6,000
	Record 30% equity in investee's $20,000 earnings.		

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Equity Investments Significant Influence: Recording Share of Dividends

- Cash dividends received by investor accounted for as conversion of one asset for another.
- Dividends reduce Equity Method Investments.
- 1/9/22: Star pays $10,000 in cash dividends.
- Equity Method Investments credited (decreased) for $10,000 × 30% = $3,000.

Jan. 9	Cash	3,000	
	Equity Method Investments		3,000
	Record 30% share of $10,000 dividend paid by Star.		

Learning Objective P5: Account for equity securities with significant influence.

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Equity Investments Significant Influence: Reporting Investments

- Book value of investment will equal cost **plus** share of earnings **minus** share of dividends.
- 1/9/22: Micron will report as shown:

Exhibit 15.7

Equity Method Investments			
1/1/2021 Investment acquisition	70,000		
12/31/2021 Share of earnings	6,000		
12/31/2021 Balance	76,000		
		1/9/2022 Share of dividend	3,000
1/9/2022 Balance	73,000		

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Equity Investments Significant Influence: Selling Investments

- When sold, will report gain or loss equal to sale proceeds minus book value of investment.
- 1/10/22: sold Star stock for $80,000.
- Gain: $80,000 proceeds minus $73,000 book value = $7,000 gain.

Jan. 10	Cash	80,000	
	Equity Method Investments		73,000
	Gain on Sale of Stock Investments		7,000
	Sold 3,000 shares of stock for $80,000.		

Learning Objective P5: Account for equity securities with significant influence.

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Learning Objective C2

Describe how to report equity securities with controlling influence.

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Equity Investments, Controlling Influence, More than 50%

Required when investor's ownership exceeds 50% of investee.

- Consolidation Method is used for long-term investments in equity securities with controlling influence.
- Consolidated financial statements show the financial statements of all entities under parent's control.

Learning Objective C2: Describe how to report equity securities with controlling influence.

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Accounting Summary for Debt and Equity Investments in Securities

Exhibit 15.8

Classification	Investments Account Reported at
Short-Term Investment in Securities	
Debt Investments—Held-to-Maturity	Cost (without any discount or premium amortization)
Debt Investments—Trading	Fair value (with fair value adjustment to income)
Debt Investments—Available-for-Sale	Fair value (with fair value adjustment to equity)
Stock Investments—insignificant influence	Fair value (with fair value adjustment to income)
Long-Term Investment in Securities	
Debt Investments—Held-to-Maturity	Cost (with any discount or premium amortized)
Debt Investments—Available-for-Sale	Fair value (with fair value adjustment to equity)
Stock Investments—insignificant influence	Fair value (with fair value adjustment to income)
Equity Method Investments—significant influence	Equity method (no fair value adjustment)
Consolidated Investments—controlling influence	Consolidation method (no fair value adjustment)

Learning Objective C2: Describe how to report equity securities with controlling influence.

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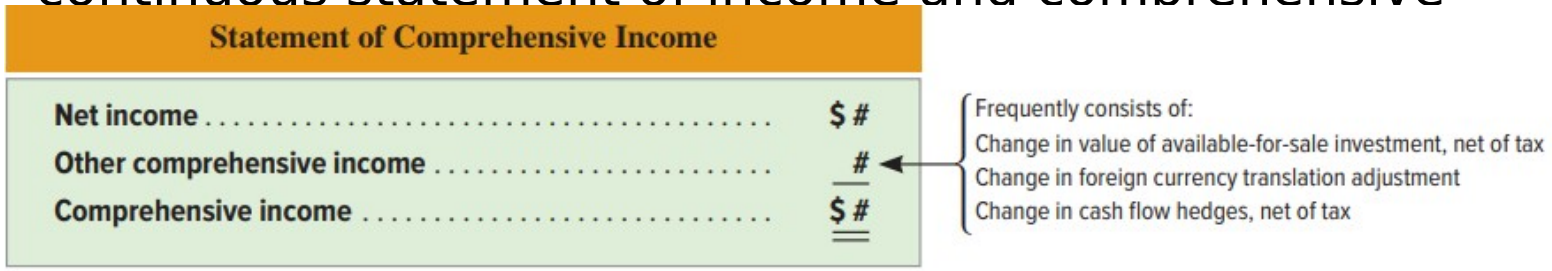
Computing and Reporting Comprehensive Income

Comprehensive Income: all changes in equity during a period except those from owners' investments and dividends.

Comprehensive Income Reporting Options:

1. Separate statement of comprehensive income that follows the income statement.
2. Lower section of the income statement (as a single continuous statement of income and comprehensive


Statement of Comprehensive Income
Net income . . . . . $ #
Other comprehensive income . . . . . #
Comprehensive income . . . . . $ #
Frequently consists of:
Change in value of available-for-sale investment, net of tax
Change in foreign currency translation adjustment
Change in cash flow hedges, net of tax

Learning Objective C2: Describe how to report equity securities with controlling influence.

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Learning Objective A1

Compute and analyze the components of return on total assets.

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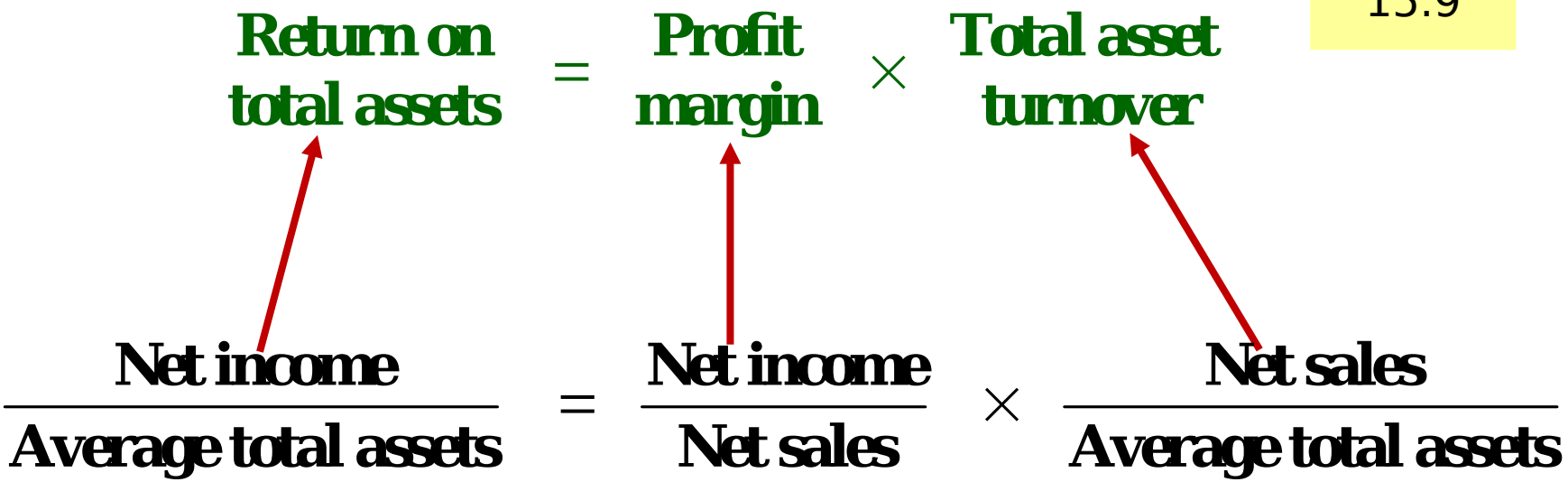
Components of Return on Total Assets

Exhibit 15.9



Learning Objective A1: Compute and analyze the components of return on total assets.

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Return on Total Assets

Exhibit 15.10

Return on total assets for Costco and Walmart

Year	Costco					Walmart
	Return on Total Assets	=	Profit Margin	×	Total Asset Turnover	Return on Total Assets
Current Year	**8.4%**	=	2.4%	×	3.5	**3.4%**
1 Year Ago	**8.1%**	=	2.2%	×	3.7	**5.2%**
2 Years Ago	**7.8%**	=	2.1%	×	3.7	**7.2%**

All companies desire a high return on total assets. To improve the return, the company must meet any decline in profit margin or total asset turnover with an increase in the other. Companies consider these components in planning strategies.

Learning Objective A1: Compute and analyze the components of return on total assets.

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End of Chapter 15

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